
FOREIGN MILITARY SALES FINANCIAL POLICIES AND PROCEDURES

By

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Effective financial planning is vital for the Foreign Military Sales (FMS) program. Responsibilities for effective FMS financial planning are shared by comptroller personnel, operations and logistics managers, and FMS purchasers. An understanding of the policies and procedures involved is essential to program success.

The purpose of this paper is to enhance that understanding. It is divided into two sections. The first describes FMS funds management in general terms to acquaint the reader with the overall subject. The second section describes the single most important FMS financial planning document, the payment schedule.

FMS FUNDS MANAGEMENT

Consideration of FMS funds requirements and potential sources of funds must start at the outset, long before the offer can be prepared. There is little reason to proceed with an offer if funding cannot be obtained or generated by the purchaser. The key, especially for large systems sales, is often determination of affordable requirements after consideration as to how these requirements will be funded. Potential sources of funds include purchaser cash and US Government credit.

Once the general decisions as to what will be offered for sale and how it is likely to be funded are made, specific items to be offered and their prices can be more clearly defined. Here too, funding considerations are very important, since prices dictate affordability and delivery timing affects funds requirements over the life of the case.

FMS prices are determined by one of several methods depending on the source of the items themselves. For items coming from procurement, contractor quotes are normally used. For stock items with standard inventory costs the standard price, adjusted for inflation, holding costs, or other factors may be used. For inventory assets without a standard price, such as aircraft or missiles, the HQ USAF Inventory Aircraft and Missile Pricing Board usually establishes a coordinated FMS price. Obviously, the pricing function can often become quite complex, particularly for systems sales which often involve spares, maintenance, training, US Government management, extraordinary transportation requirements, and so forth, as well as the primary weapon itself. The case manager must be careful at this point to accumulate and compile all estimated costs and prices to ensure against unwelcome surprises later during actual case implementation.

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In any event, once the estimated prices and costs are accumulated the case manager involved with a major systems sale is prepared to develop the draft Letter of Offer and Acceptance, DD Form 1513, and to request the financial analyst in AF/PRIM to prepare a payment schedule. The payment schedule spreads purchaser payments over the actual period of performance to meet case requirements needed by DOD to meet disbursing requirements. In this way, the implementing agency and the US Government are reasonably assured that funds will be available prior to need to conduct the case and to comply with the AECA.

However, fund availability is only one function of the payment schedule. The second major function is to advise the foreign purchaser of time-phased cash requirements in order that in-country budgetary planning can be effectively performed. This notification is important since few events are so unsettling to a purchaser than large, unanticipated funds requirements after FMS cases are signed and partially implemented. For both these reasons, the payment schedule is one of the key financial planning documents in the FMS process.

The payment schedule itself usually consist of two sections -- an initial deposit and a stream of subsequent quarterly payments designed to ensure funds are available when needed to conduct the case. The purpose of the initial deposit is to provide case funding until such time as the Security Assistance Accounting Center (SAAC) can generate billings and receive payments under its standard quarterly billing schedule. The purchaser must remit the initial deposit to SAAC along with the signed DD Form 1513 before case performance can begin. All purchaser payments are deposited in the FMS Trust Fund Account for which SAAC has accounting responsibility.

During the period of performance, funds are made available from SAAC to implementing commands (AFLC, AFSC, SAC, TAC, etc.) via the use of obligation/expenditure authority at the appropriate times. Obligation authority, when granted by SAAC, allows obligations to be incurred within a given case. The term obligation refers to orders placed, contracts awarded, services received, and similar transactions during a given period which will require payments during the same or future periods. Obligation authority may be approved for full LOA value, regardless of payments. Expenditure authority is the authority from SAAC which allows expenditures to be incurred against obligations previously recorded against a country's trust fund account. The "expenditure" is the equivalent of a cash disbursement. Before it can be made, the dollars must be on deposit in the trust fund. Automated procedures are involved and systems used by the commands and the Air Force for both logistical and financial control are integrated with each other as well as with systems used by SAAC and the Defense Security Assistance Agency (DSAA) for these same purposes. The goal is to provide logistical and financial oversight and control over the life of the case. (Detailed descriptions of various forms and procedures used for these purposes exceed the scope of this paper.)

Further, for large systems sales periodic meetings involving the HQ USAF case manager, representatives from the implementing commands, and sometimes the purchaser are held to discuss and evaluate progress.

Financial as well as logistical matters are discussed. The result is often a modification to the DD Form 1513 to redirect funds as necessary. Often, the changes are so extensive that payment schedules must be reaccomplished to reflect revised funds requirements, both in timing and amount.

Ultimately, the initial weapons system sale will be completed and the case can be closed. Prior to closure, however, the various logistical and financial control systems must be closely reconciled. Once this reconciliation is done, the case can be certified to SAAC for closure.

FMS PAYMENT SCHEDULES

As indicated above, FMS purchasers are required to deposit cash in advance of delivery of most articles and services. Exceptions are rare. Each DD 1513 includes a financial annex and payment schedule which explains the purchaser's responsibility for making payments to the US Government and provides budgetary planning data. In general, payment schedules include estimates of outlays for sales from DOD stocks, sales from procurement, DOD services and training, administrative charges, accessorial and transportation charges, the contingencies such as contractor holdback and termination liability, explained below.

Payment schedules usually consist of an initial deposit and estimated quarterly billing amounts. If an initial deposit is required, it should be sufficient to cover all costs and contingencies anticipated until the first billing statement can be rendered by SAAC and funds can be collected from the customer. In all cases, payment schedule preparation requires making budgetary estimates under conditions of inflationary uncertainty and uncertainty as to the specific dates when:

- Purchasers will accept and return the DD Form 1513 for implementation;
- Requisitions for items will be initiated;
- Contracts will be let;
- Progress payments will be made to contractors;
- Deliveries of items, particularly spare parts and support equipment, will occur; and
- Personnel costs will be incurred.

Further, the OSD Comptroller requires that the US Government collect funds to match "termination liability" on procurement contracts. Termination liability is the best estimate of the costs that would accrue should a particular case or program be completely terminated. Ideally, these costs should equal the negotiated settlement that would be reached with the supplier of an item or service at some point in time prior to the normal completion of the contract and without consideration of possible diversion options.

Obviously, termination liability can never be precisely determined unless an unanticipated termination actually occurs. Nevertheless, this amount must be estimated and collected as part of the purchaser's schedule of payments for deposit in the Foreign Military Sales Trust Fund. Furthermore, termination liability reserve requirements change regularly as contracts are awarded, work progresses, purchaser payments are received, and deliveries are made.

This means that discrete termination costs must be developed for the various payment dates throughout the life of the case. Of course, the bulk of the termination reserves are established as part of the early collections from the purchaser and are phased out thereafter. These reserves ultimately zero-out as cases mature and are delivered out.

Contractor holdback is a US Government procurement practice which reduces progress payments to contractors by a percentage of the amount due. In essence, they serve to guarantee continued contract performance. As contract milestones are achieved and the contract is satisfactorily completed, the contractor holdback reserves are reduced, since the amount held back is included in subsequent payments to the contractor.

DOD components are expected to scrutinize closely and continually the accuracy of payment schedules on new and existing cases. For existing cases, revisions to the payment schedule are mandatory when:

- Price increases cause substantive revisions of the payments from those shown on the existing payment schedule.
- Actual cash expenditures for FMS transactions exceed the cash flow received from the purchasing country in accordance with the current payment schedule.
- A formal amendment (DD Form 1513-1) adjusts the total estimated case value. Such amendments must include a revised payment schedule.
- Adjustments are made to multi-year payment schedules (normally done annually).
- Availability (delivery timing) changes or funds are shifted among subcases with different availability dates, whether or not total case value is affected.

Unless otherwise noted above, DD Form 1513-2, Notice of Modification, is used to advise the purchasing country of payment schedule revisions.

Occasionally, payment schedules may appear to result in too-early collection of funds. Where this is the case, detailed analysis must be undertaken to determine the facts in the particular case and take corrective action if necessary. Reasons for apparent or actual early collections may include:

- Inflated price estimates;
- Delivery reporting delays or errors;
- Contract award delays;
- Late contractor billings;
- Unreported slips in articles/services deliveries;
- DSAA-approved customer requests for accelerated payments; or
- Data misinterpretation.

In any event, the key to development of good payment schedules is in good estimates of when articles and services will actually be delivered during case performance.

For systems sales, this information must come from implementing line managers at the major commands, notably the Air Force Logistics Command (AFLC) and the Air Force Systems Command (AFSC). Their estimates of delivery timing (referred to as stated availability in the DD Form 1513) are used to derive the timing of funds requirements. Using these estimates, the AF/PRIM analysts can use computerized procedures to produce both payment schedules and termination liability worksheets. These procedures are described below.

PAYMENT SCHEDULE PROCEDURES AT HQ USAF

Payment schedules and termination liability worksheets for all HQ USAF written FMS cases are prepared or approved by AF/PRIM. The primary input for their preparation is a draft DD 1513, -1, or -2 indicating estimated costs, delivery dates (availability), and appropriate accessorials, e.g., transportation, asset use charges, nonstandard administrative charges, etc. The draft documents are reviewed for math accuracy and the price and availability information is traced to supporting documents which usually come from implementing commands. If a case notice or amendment is involved, previous case documents are checked to ensure all appropriate information is accurately brought forward. Further, recorded obligations are checked to insure they are not greater than revised line values, and expenditures are checked to insure they don't exceed revised line values.

Once this initial review is completed, the payment schedule can be prepared or approved. Manual procedures are sometimes used for small, simple cases. These are relatively rare. Also rare are systems sales for which a System Program Office prepared payment schedule is available. These are reviewed for reasonableness but are generally used unchanged. However, for most cases, AF/PRIM financial section personnel use a computerized payment schedule program developed by the Air Force Data Services Center.

To use the payment schedule program, certain DD Form 1513 factors must be manually entered into the computer. These variable factors may include line numbers, prices, delivery schedules, procurement availability, sources of supply, offer expiration dates, and accessorial or administrative charges with their associated percentages. All appropriate variables are entered by subcase, and subcases themselves can be further broken down if delivery schedules, transportation, or accessorial charges warrant. Further, the analyst must specify, for each subline or "sub-subline," how the computer is to spread the associated required payments. Several methods are available, as explained below.

Most subcases involving procurement are spread according to an internally programmed curve derived from Table 401-1, DOD 7290.3M. This curve is now undergoing validity testing with a near-term goal of developing a "family of curves" which would be end-item-specific. In any event, use of

the built-in curve permits automatic computation and printout of termination liability and contractor holdback reserves.

Subcases involving items from inventory or services are normally straight-lined over the stated period of availability. The logic for this straightlining is that it's difficult to predetermine when, exactly, most deliveries will occur. However, the program permits the analyst to custom-design any curve desired. The design is developed by specifying precise percentages of the line value for each month of stated line availability. This procedure is useful where case/line managers are able to specify exactly when deliveries of assets or services will take place.

Obviously, the payment schedule program is versatile now and is constantly becoming more so as refinements are added. However, the output, payment schedules and termination liability worksheets can be no more accurate than the variable factors entered up front. These factors, usually obtained from line managers at implementing commands, are the critical elements. The more specific and accurate they are, the better the payment schedule can be. Accurate pricing and availability data is the key. Those responsible for its provision must be as specific as possible and must notify case managers when it changes. The result will be accurate payment schedules and termination liability worksheets.

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